

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA



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In the Matter of the Application of Southern  
California Gas Company (U 904 G), San Diego  
Gas & Electric Company (U 902 M) and  
Southern California Edison Company (U 338 E)  
for Approval of Changes to Natural Gas  
Operations and Serving Offerings

A.06-08-026

**REPLY BRIEF OF  
THE INDICATED PRODUCERS**

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July 20, 2007

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**REPLY BRIEF OF  
THE INDICATED PRODUCERS**

Pursuant to the bench ruling of May 18, 2007 and Rule 13.11 of the Commission's Rules of Practice and Procedure, the Indicated Producers<sup>1</sup> (IP) submit this reply brief on the proposal of Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E) and Southern California Edison Company (SCE) (collectively Applicants) to implement changes to natural gas operations and service offerings (Application).

**I. INTRODUCTION AND SUMMARY**

Applicants propose a series of changes that will expand the System Operator's (SO) role, create new balancing rules for the core, and provide new opportunities for shareholder reward. The Application and opening brief of SoCalGas/SDG&E characterize the proposed changes as measures to address concerns expressed in underlying settled cases, to promote transparency and to

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<sup>1</sup> The Indicated Producers is an *ad hoc* coalition which includes, for the purposes of this brief, Aera Energy LLC, BP Energy Company, BP America Inc. (including Atlantic Richfield Company), ConocoPhillips Company, Chevron U.S.A. Inc., Midway Sunset Cogeneration Company (an affiliate of Aera Energy) and Occidental Energy Marketing Inc.

reduce utility cost of service for customers. Applicants have failed, however, to demonstrate that the proposed changes will achieve these goals. Instead, Applicants' proposals present a risk of detrimental impact on noncore customers and competition. The only certain result of these proposals will be to create new no-risk opportunities for shareholder reward. For these reasons, the Commission should reject the Application or, at a minimum, adopt changes to mitigate the risk of detrimental impact on customers and competition. A detailed list of recommended modifications is attached as Appendix A.

## **II. THE PROPOSED CHANGES DO NOT ACHIEVE THE PURPORTED BENEFITS**

Applicants indicate that the proposed changes in this Application are directed to, among other things, address concerns of unfair competition and market manipulation that gave rise to the Continental Forge and Border Price Spike cases and to reduce utility cost of service for customers.<sup>2</sup> The record and the opening briefs, however, indicate that many of the concerns that gave rise to the Continental Forge and Border Price Spike cases will remain,<sup>3</sup> the proposed postings will only provide limited transparency,<sup>4</sup> and utility cost of service for noncore customers will increase.<sup>5</sup>

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<sup>2</sup> See SoCalGas/SDG&E Opening Brief, at 4-5; Application, at 8.

<sup>3</sup> As discussed in IP's Opening Brief, the proposed changes will put the SO in a position of will have cost and informational advantage as it competes with marketers and holders of storage assets. See IP Opening Brief, at 13-16. Coral's opening brief reflects concern about the consolidated core increasing market power concerns. See Coral Opening Brief, at 7-12.

<sup>4</sup> The record demonstrates that while net weekly hub positions will be posted on the electronic bulletin board (EBB) the SO's purchases and sales of gas will not. 4 Tr. 525-555, SoCalGas/SDG&E/Schwecke. Both Coral and IP's opening briefs argue that additional postings are needed to make operations more transparent and ensure fairness. See Coral Opening Brief, at 52-53; IP Opening Brief, at 19-20.

<sup>5</sup> The record indicates that noncore customer cost of service will increase. See IP Opening Brief, at 11. The record also demonstrates that minimum flow requirement purchases

SoCalGas/SDG&E's opening brief also provides little basis to believe that the proposed changes will achieve the goals asserted in the Application.

SoCalGas/SDG&E seek adoption of all the proposed changes as a complete package due to the "*extensive regulatory and civil litigation, negotiations, and compromise,*" resulting in "*a comprehensive package that reflects a delicate balancing of a multitude of interests.*"<sup>6</sup> SoCalGas/SDG&E do not go further to discuss how the proposed changes actually address the concerns in the underlying settled cases.<sup>7</sup>

The utilities likewise fail to respond to the argument that shifting the system reliability role to the SO will increase costs to noncore customers. SoCalGas/SDG&E state only that "*any additional costs to noncore customers from this shift in responsibility will likely be offset by the benefits they receive from other proposals.*"<sup>8</sup> SoCalGas/SDG&E do not identify which proposals will offset admitted cost increases or how "likely" such an offset will be.

For the most part, the record evidence and SoCalGas/SDG&E's opening brief fail to identify concrete benefits for ratepayers or competition as a result of their proposals.<sup>9</sup> The Commission thus should reject the Application – an application in which the only certainty is increased shareholder reward.

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can be as high as 652 MMcf/d which means the cost increase will be quite significant. See Exh. 25, SCGC/Yap Attachment F, SCGC DR 5.5. Applicants have not demonstrated that any of the proposed changes will offset this increase.

<sup>6</sup> SoCalGas/SDG&E Opening Brief, at 6.

<sup>7</sup> While SCE's opening brief indicates that SCE is content that the changes are a "*step in the right direction,*" as they will affect all market participants, the changes must be reviewed from the viewpoint of all market participants.

<sup>8</sup> SoCalGas/SDG&E Opening Brief, at 7.

<sup>9</sup> There are a couple of proposals that will help customers manage costs and increase competition. The fifth nomination cycle will allow customers to manage transportation imbalances. In addition, the changes which will allow noncore customers to assign

### **III. THE PROPOSED CHANGES CREATE THE POTENTIAL FOR ADVERSE IMPACTS ON NONCORE CUSTOMERS AND COMPETITION**

The Applicants propose to greatly expand the SO's role and create new balancing rules for the core so that the core can be treated like the noncore class.<sup>10</sup> The limited information revealed at the hearings indicates that the changes may lead to adverse impacts on noncore customers and competition. To limit these impacts, guidelines and a reasonableness review should be implemented to monitor the SO's actions, core balancing should be deferred to the next BCAP and measures should be taken to monitor the occurrence of operational flow orders (OFOs).

#### **A. The Proposed Changes May Adversely Affect Noncore Customers**

##### **1. Shifting System Reliability Responsibility to the System Operator Will Increase Costs for Noncore Customers.**

SoCalGas/SDG&E indicate that the proposed changes will result in a *“direct reduction in costs of utility service”* and suggest that any cost shifts to noncore customers will be offset.<sup>11</sup> SoCalGas/SDG&E admit, however, that shifting the responsibility of maintaining system reliability will increase costs for noncore customers.<sup>12</sup> They also fail to quantify this cost increase, propose any performance guidelines, or suggest use of a reasonableness review.<sup>13</sup> With limited transparency<sup>14</sup> and neither performance guidelines nor a reasonableness

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storage rights and provide hub services will create a secondary market for these services.

<sup>10</sup> SoCalGas/SDG&E Opening Brief, at 28-29.

<sup>11</sup> SoCalGas/SDG&E Opening Brief, at 4-7.

<sup>12</sup> IP Opening Brief, at 11.

<sup>13</sup> 4 Tr. 554, SoCalGas/SDG&E/Schwecke.

<sup>14</sup> 4 Tr. 553-554, SoCalGas/SDG&E/Schwecke.

review, there will be no limit to the costs that the SO will be able to incur. Several stakeholders, including Coral, SCGC and DRA, share the concern over lack of SO oversight.<sup>15</sup>

SoCalGas/SDG&E do not adequately address these concerns about the SO's scope of authority. SoCalGas/SDG&E state only that shifting the minimum flow requirement obligation to the SO is appropriate because it is part of the exchange which allegedly complements the core balancing proposal.<sup>16</sup> They also state that an expedited advice letter process is appropriate because *"interested parties such as Coral and SCGC will undoubtedly ensure that any such expedited advice letters provide full disclosure of all pertinent details."*<sup>17</sup>

Both explanations fail to provide assurances that SO costs spread to customers will be reasonable.

If the Commission grants the utilities' request to expand the SO's role, measures must be adopted to mitigate the potential for adverse impacts on customers and competition. As a starting point, the SO should be required to abide by the following guidelines:

- (1) All gas purchases and sales (with information regarding volumes, prices, dates, delivery or receipt points and special terms) by the SO should be posted on the electronic bulletin board (EBB). This includes all purchases to and sales from the Gas Procurement Department and affiliates;
- (2) SoCalGas/SDG&E should be required to seek approval of all tools used, regardless of whether they require payment of a demand or reservation charge;

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<sup>15</sup> See SCGC Opening Brief, at 33-39; Coral Opening Brief, at 52-59; DRA Opening Brief, at 28-29.

<sup>16</sup> SoCalGas/SDG&E Opening Brief, at 32.

<sup>17</sup> *Id.*, at 33-34.



- (3) The costs incurred in the System Reliability Memorandum Account (SRMA) should be subject to a reasonableness review before being passed through to customers;<sup>18</sup> and
- (4) SoCalGas/SDG&E's use of an expedited advice letter process for the approval of new SO tools should be rejected.

## **2. The Core Balancing Proposal Will Limit Noncore Customers' Use of System Balancing Assets.**

Applicants' propose to subject the core to new balancing rules with the stated objective of requiring the core class to abide by the same rules imposed on noncore customers.<sup>19</sup> This change, which the utilities perceive as a benefit, does not achieve the stated objective and creates the potential for adverse impacts on other customers.

Contrary to Applicants' assertions, the core class and noncore class will not receive similar treatment. While noncore customers' imbalances are calculated by comparing nominations to actual daily use, core imbalances will be calculated using forecasted usage.<sup>20</sup> In addition, the core will gain additional flexibility in its procurement strategy as a result of access to 5.3 Bcf of balancing assets, set-aside and paid for by noncore customers.<sup>21</sup>

The proposed balancing treatment could affect noncore customer flexibility. As revealed at hearings, core balancing will provide the largest single user of the SoCalGas system the most flexibility in balancing.<sup>22</sup> The sufficiency

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<sup>18</sup> All of the SO's reliability-related costs will be tracked in the SRMA. The balance of this account will be spread to all customers on the basis of cold-year throughput. See Exh. 63, SoCalGas/SDG&E/Austria, at 6-7.

<sup>19</sup> SoCalGas/SDG&E Opening Brief, at 28-29.

<sup>20</sup> IP Opening Brief, at 23-24.

<sup>21</sup> 6 Tr. 923, SCE/Pickett; 3 Tr. 377, SoCalGas/SDG&E/Morrow.

<sup>22</sup> Coral witness Dyer approximates that the SoCalGas Gas Procurement Department currently purchases 46% of the gas in the SoCalGas market. This percentage is likely to

of the 5.3 Bcf to serve the noncore and core classes has also not been demonstrated.<sup>23</sup> Finally, applicants have not proposed any change to the cost allocation of these assets.<sup>24</sup> This means that if core balancing is approved, noncore customers will continue to pay for all system balancing assets despite the fact that they may not be able to access them when needed.<sup>25</sup>

For these reasons, the evidence is insufficient to support the Applicants' proposal. Consideration of the core balancing proposal should be deferred to the next Biennial Cost Allocation Proceeding (BCAP).

### **3. A Higher Incidence of Operational Flow Orders Can Increase Costs for Noncore Customers.**

SoCalGas/SDG&E state that the proposed changes present a package that will provide significant benefits including a direct reduction in costs of utility services.<sup>26</sup> The record, however, demonstrates that the proposed changes have the ability to increase the number of OFOs called on the system and increase costs. In particular, core balancing will provide the largest SoCalGas customer with an additional 10% of balancing assets<sup>27</sup> and storage inventory targets will

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<sup>23</sup> increase if the proposal to consolidate the cores of SoCalGas and SDG&E is approved. See Exh. 59, Coral/Dyer, at 5-6. Importantly, in the decision adopting the Comprehensive Settlement Agreement, the parties agreed to reduce the core storage reservation from 70 Bcf to 55 Bcf of inventory, with 35 Bcf to be allocated to reliability and balancing. D.01-12-018, A.99-07-003 (12/11/01) at 57.

<sup>24</sup> See IP Opening Brief, at 27-28.

<sup>25</sup> *Id.*

<sup>26</sup> SoCalGas/SDG&E Opening Brief, at 4-5.

<sup>27</sup> Dr. Van Lierop indicated that the core's flexibility on an OFO day will remain the same but the core would have *more* assets available for balancing on non-OFO days. 1 Tr. 138-39, SoCalGas/SDG&E/Van Lierop.

increase core flexibility and may result in the largest portion of injections occurring during periods of peak system use.<sup>28</sup>

As discussed above, IP urge the Commission to reject the Application or, at a minimum, defer the core balancing issue to the next BCAP. In addition, OFO protocols should be implemented and a review committee created in a manner similar to the PG&E committee developed in the Gas Accord.<sup>29</sup> Together the protocols and the committee can monitor impacts and, if necessary, develop measures to reduce the number of OFOs on the system. Since customers incur large penalties when OFOs are called, such measures would help prevent unnecessary cost increases.

**B. The System Operator's Role As A Marketer Carries The Potential To Adversely Affect Competition.**

The opening briefs reflect concern about the ability of the SO to impact competition.<sup>30</sup> In particular, Coral observes that the SO will not be required to pay firm access right (FAR) charges and other charges required of other marketers.<sup>31</sup> Coral also expresses concern about the impact SO tools may have on competition.<sup>32</sup> Finally, both Coral and SCGC voice concern about the process

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<sup>28</sup> Core storage targets merely establish minimum targets so it is possible that in aiming to meet established targets, the Gas Procurement Department will put so much gas onto the system that an increased number of OFOs could be called. See IP Opening Brief, at 36.

<sup>29</sup> See IP Opening Brief, at 36.

<sup>30</sup> As proposed by the Applicants, the SO, in its expanded role, would compete with marketers in the purchase and sale of natural gas and all customers holding storage assets in its provision of hub services. See IP Opening Brief, at 12-13.

<sup>31</sup> Coral Opening Brief, at 53, 58-59. IP also contends that the SO should be required to abide by the same rules as other marketers. See IP Opening Brief, at 12-21.

<sup>32</sup> See Coral Opening Brief, at 57-58.

to be used by the SO to seek approval of chosen reliability tools.<sup>33</sup> The impact of the SO on competition would, no doubt, be an unintended consequence of its new expanded role and must be minimized.

To limit the impact of competitive advantages the SO will have in the hub services market, it should be precluded from accessing customer-specific data and it should be required to purchase FARs. In addition, to allow sufficient time to review tools chosen by the SO, the request to use an expedited advice letter process should be rejected.

Another way to minimize the SO's impact on competition is to limit the SO's presence in the market so that the SO would be precluded from engaging in retail sales, consistent with prior Commission decisions. In D.90-09-089, concerned with allegations that the utilities had too many advantages over competitors, the Commission adopted a settlement agreement that precluded retail marketing.<sup>34</sup> That decision continues to be relevant in this context where the purpose of the application is to address underlying concerns including unfair competition. Increasing the scope of the utilities and their affiliates in the retail market would be both inconsistent with the overarching objectives of the settlements underlying this proceeding and with D.90-09-089.<sup>35</sup>

Finally, transparency in the SO's provision of hub services should be increased. Applicants have only proposed that the SO post net weekly hub

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<sup>33</sup> Coral Opening Brief, at 50-57; SCGC Opening Brief, 35-39. IP's Opening Brief also expresses concern about the review process proposed by Applicants and the lack of review in many cases. See IP Opening Brief, at 8-11.

<sup>34</sup> D.90-09-089, at 590, 594. At the hearings, Mr. Schwecke acknowledged SoCalGas currently cannot sell gas to noncore customers. 4 Tr. 502, SoCalGas/SDG&E/Schwecke.

<sup>35</sup> Importantly, if the SO is allowed to purchase and sell gas, there will be a total of seven Sempra entities that can market gas. 4 Tr. 552 (There currently exist six affiliates that can enter into transactions with the SO.)

positions.<sup>36</sup> This provides inadequate information about the quantity and prices of ongoing hub transactions. Without this information there is no way to monitor the SO's impact on competition.<sup>37</sup>

In summary, to minimize the SO's potential impact on competition, the following should be implemented:

- (1) The SO should be precluded from access to customer-specific information or data to avoid unfair advantage in the hub services market;
- (2) To minimize the SO's cost advantage, it should be required to purchase FARs;
- (3) The SO should be prohibited from making sales to the noncore retail market. All wholesale sales of gas to marketers should also be posted on the EBB; and
- (4) The SO should be required to post the provision of all hub services on a daily basis.

#### **IV. ADDITIONAL OPPORTUNITIES FOR SHAREHOLDER REWARD SHOULD BE DENIED WHERE THEY DO NOT SUBJECT SHAREHOLDERS TO AN EQUAL LEVEL OF RISK**

While the benefits of the proposed changes on noncore customers remains dubious, it is clear that shareholders will have new opportunities to recoup and/or maximize shareholder rewards. In fact, in opening briefs, several

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<sup>36</sup> SoCalGas/SDG&E claim that daily postings will burden core customers but the postings advocated by IP would be made by the SO so this argument is without merit. See SoCalGas/SDG&E Opening Brief, at 36. SoCalGas/SDG&E also argue that because the active parties in the underlying cases were satisfied by these postings, Coral and IP, who find them inadequate, should also be content with them. See *id.*, at 36-37. As the Commission has made clear, the settlement agreements underlying this Application are not governed by Rule 12 and therefore are not binding on parties in this forum. The proposals of the Omnibus Application are to be evaluated based on the proposal's individual merits. See D.06-12-034, at 9.

<sup>37</sup> Individual transactions will not be revealed through weekly net hub positions. See 4 Tr. 564, SoCalGas/SDG&E/Schwecke.

parties voiced their concern about the unfairness of these requests.<sup>38</sup> These requests should be rejected where new opportunities for shareholder reward will subject shareholders to little or no risk.<sup>39</sup> The request for 90/10 revenue sharing for interruptible access charge revenues should be denied on the basis that it is procedurally inappropriate.<sup>40</sup>

SoCalGas/SDG&E argued at hearings and in their opening brief that it is short-sighted of the Commission to think that SoCalGas would market and promote services with the same level of vigor absent a financial incentive.<sup>41</sup> Incentives, however, resulting from the utilities' authorized rate of return and performance based incentive (PBI) mechanism, already exist to sufficiently encourage efficient and innovative behavior.<sup>42</sup> To ensure equity, where opportunities in addition to the authorized rate of return and PBI are proposed, shareholders should be exposed equally to risk and reward. For this reason, where SoCalGas/SDG&E cannot demonstrate that new requests for shareholder reward would subject shareholders to an equal amount of risk, the requests for

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<sup>38</sup> See Coral Opening Brief, at 27-29 and 54-56 (noting concern about shareholder rewards under GCIM mechanism, advocating 100% balancing treatment for SRMA and rejection of request for 90/10 sharing for interruptible access charge revenues); SCGC Opening Brief at 11-12, 33, and 34 (recommending reduction of shareholder revenue cap, for unbundled storage program and hub service program, from \$20 million to \$5 million and rejection of request for 90/10 sharing for interruptible access charge revenues).

<sup>39</sup> By the application, Applicants seek 50/50 sharing of hub revenues provided by the SO, 90/10 sharing of interruptible access charge revenues, changes to core balancing that will increase the Gas Procurement Department's (GPD) ability to engage in after-market sales, and a shift of the system reliability function to the SO which can lower the GPD's procurement costs because there will no longer be "lost opportunity costs." See IP Opening Brief, at 30-31.

<sup>40</sup> Coral, DRA, IP and SCGC all oppose the 90/10 sharing of interruptible access charge revenues based on the findings in D.06-12-031. See SoCalGas/SDG&E Opening Brief, at 50. See *also* IP Opening Brief, at 21-28.

<sup>41</sup> See SoCalGas/SDG&E Opening Brief, at 50-51.

<sup>42</sup> Mr. Dyer's testimony indicates that from 1998 through 2005, shareholders averaged 15.65% while the authorized rate of return on common equity averaged 11.31%. See Exh. 59, Coral/Dyer, at 37.

new opportunities should be denied. At a minimum, the Commission should modify Applicants' requests in the following way:

- (a) Adopt 90/10 sharing of hub service revenues, pursuant to Schedule G-PAL, in place of the proposed 50/50 sharing; and
- (b) Reject 90/10 sharing of interruptible access charge revenues as a result of the findings in D.06-12-031.

## **V. REQUEST FOR RELIEF**

Overall, Applicants present an underdeveloped case which fails to explain the purpose and full cost impact of many of the proposed changes. Where Applicants have not demonstrated that the proposed changes will achieve the asserted benefits, they should be rejected. Where the proposals are not rejected on this basis, the Commission should adopt mitigation measures and safeguards to prevent unintended adverse consequences on customers and competition as summarized herein and in the IP opening brief.

July 20, 2007

Respectfully submitted,  
Alcantar & Kahl LLP

A handwritten signature in black ink, appearing to read "Evelyn Kahl".

Evelyn Kahl  
Seema Srinivasan

Counsel to the Indicated Producers

## **APPENDIX A**

### **IP List of Recommendations**

- (1) Guidelines, applicable to the System Operator (SO), should be adopted to ensure that impacts on noncore customers and competition can be minimized:
  - (a) All gas purchases and sales (with information regarding volumes, prices, dates, delivery or receipt points and special terms) by the SO should be posted on the electronic bulletin board (EBB). This includes all purchases to and sales from the Gas Procurement Department and affiliates;
  - (b) SoCalGas/SDG&E should be required to seek approval of all tools used, regardless of whether they require payment of a demand or reservation charge;
  - (c) The costs incurred in the System Reliability Memorandum Account (SRMA) should be subject to a reasonableness review before being passed through to customers; and
  - (d) SoCalGas/SDG&E's use of an expedited advice letter process for the approval of new SO tools should be rejected.
  - (e) The SO should be precluded from access to customer-specific information or data to avoid unfair advantage in the hub services market;
  - (f) To minimize the SO's cost advantage, it should be required to purchase firm access rights (FARs); and
  - (g) The SO should be prohibited from making sales to the noncore retail market. All wholesale sales of gas to marketers should also be tracked.
  - (h) The SO should be required to post the provision of all hub services on a daily basis.
- (2) Core balancing proposal should be deferred to the next biennial cost allocation proceeding (BCAP) to allow consideration of cost allocation and to review the sufficiency of balancing assets to serve needs of both noncore and core customers.

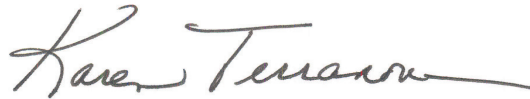


- (3) New opportunities for shareholder reward should be rejected where potential for reward is not equal to the level of their financial risk. To mitigate inequity, the following modifications to Applicants' proposals should be made:
- (a) 90/10 sharing of hub service revenues, pursuant to Schedule G-PAL, should be adopted in place of the requested 50/50 sharing.
  - (b) The proposal to implement 90/10 sharing of interruptible access charge revenues should be rejected consistent with D.06-12-031.

## CERTIFICATE OF SERVICE

I, Karen Terranova hereby certify that I have on this date caused the attached **Reply Brief of the Indicated Producers** in A.06-08-026 to be served to all known parties by either United States mail or electronic mail, to each party named in the official attached service list obtained from the Commission's website, attached hereto, and pursuant to the Commission's Rules of Practice and Procedure.

Dated July 20, 2007 at San Francisco, California.

A handwritten signature in cursive script, reading "Karen Terranova", written in black ink.

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